Manitoba

Manitoba's Position on National Tax Reform

Presented
to the
House of Commons
Standing Committee
on
Finance and Economic Affairs

Honourable Eugene Kostyra
Minister of Finance

September, 1987

The tax reforms proposed in the federal government's White Paper represent the first step toward building a fairer tax system. We appreciate this forum for discussion and are confident that the work of the Committee will add immeasurably to the refinement of the tax reform package.

Our Government has repeatedly called for a comprehensive reform of the national tax system since Premier Pawley first raised this issue at the February 1982 First Ministers' Conference. Last year we welcomed Ottawa's announcement of its intention to undertake a complete examination of the income taxes and the federal sales tax. We have consistently given this issue the highest priority in our discussions with the federal government.

Need for Reform

The Canadian tax system has become excessively complex and unfair. Ordinary Canadians see the tax system as an elaborate construction designed to favour wealthy individuals and big business who can afford sophisticated tax-planning advice. They have seen tax avoidance become a growth industry, even as basic services for Canadians are being cutback.

Our tax system, with its eroded revenue bases and accumulated inequities, has distorted decision making in unnecessary and profoundly harmful ways. Tax reform is urgently needed to secure sufficient revenues to provide the services Canadians need.

Programs delivering quality medical care, education, income protection for the elderly, the unemployed, as well as programs to promote economic development and assist disadvantaged regions are under pressure. Provinces, and Manitoba in particular, have seen federal contributions through the Equalization and Established Programs Financing programs decline in relation to the requirements for vital services. In addition to preserving and protecting these important public services, Canadian governments must face the challenges presented by our changing economy and the ongoing crises in our primary industries. In this environment tax reform has become an urgent necessity.

The White Paper is an acknowledgement that our tax system has lost its integrity with most ordinary Canadians. It recognizes that the personal and corporate income tax bases have been undermined by numerous tax preferences -- introduced by successive Liberal and Conservative administrations -- which do not serve the objectives either of fairness or of efficiency.

Ottawa has come to rely increasingly on personal income taxes for the bulk of its revenue. During the early 1950s, corporate income taxes contributed more to the federal treasury than the personal income taxes. By the early 1960s, personal income tax revenues exceeded the corporate by almost one-third. For 1987 tax year, pre-reform, personal income tax revenues are expected to be four times as large as corporate income taxes.

Recent federal budgets have been particularly damaging to the progressivity of our tax system.

- The top marginal tax rates facing high income Canadians have been reduced in virtually every "tax reform" effort since 1971.

  Before 1972, the combined federal and provincial income taxes in the highest brackets were typically over 80%. The highest rates were reduced to the mid-60% range in 1972, and most recently in 1981, to the mid-50% range.

  Much of the base-broadening in these Budgets has not been permanent. Reductions in the tax rates for the wealthy are virtually the only enduring feature of earlier tax reform efforts.

- The $500 federal tax reduction for low- and moderate-income Canadians was steadily reduced and ultimately eliminated in 1985.

- The lifetime capital gains exemption was introduced in 1985.

- Increases in contribution limits for RRSPs were increased to benefit upper-middle and high-income individuals.

The cumulative impact of the tax changes introduced since 1981 have been extremely regressive. The burden of taxation has shifted dramatically to lower- and moderate-income Canadians.

AVERAGE FEDERAL PERSONAL INCOME TAXES IN MANITOBA
COMPARISON OF 1981 AND PRESENT SYSTEMS

Income Group ($)	1981 System ($)	Present System ($)	Change ($)
Under $15,000	296	488	192
$15,000 - $30,000	1,924	2,251	327
$30,000 - $50,000	4,563	5,092	529
$50,000 - $100,000	10,035	10,171	136
Over $100,000	39,228	34,147	(5,081)
All Groups	2,503	2,779	276

The comparison includes only the effect of income tax changes. Positive initiatives, such as increases in the child tax credit and the introduction of a refundable sales tax credit, have been more than cancelled out by the combination of curtailed family allowances and increased federal sales and excise taxes.

General Assessment of the White Paper Proposals

During the consultations leading up to the release of the White Paper, our Government set out objectives for national tax reform and recommended concrete actions necessary to restore a measure of fairness to the national tax system.

Our Government has analysed the proposals against the principles and goals Manitoba outlined before the White Paper was released:

- restoration of fairness and equity to the tax system;
- fairer balance between the taxes paid by people and by corporations, and between labour and investment income;
- stable, predictable, and adequate revenue bases;
- a comprehensive annual review of tax expenditures.

The most basic test of proposed tax reform measures, in our view, is fairness: do the measures represent an improvement in this critical respect?

Our analysis strongly suggests that the personal income tax changes proposed in the White Paper do not go far enough to ensure a fair contribution from wealthy Canadians especially when viewed against the backdrop of recent federal Budgets.

AVERAGE FEDERAL PERSONAL INCOME TAXES IN MANITOBA
COMPARISON OF PRESENT AND PROPOSED SYSTEMS

Income Group ($)	Present System ($)	Proposed System ($)	Change ($)
Under $15,000	488	433	(55)
$15,000 - $30,000	2,251	2,051	(200)
$30,000 - $50,000	5,092	4,881	(211)
$50,000 - $100,000	10,171	9,920	(251)
Over $100,000	34,147	32,852	(1,295)
All Groups	2,779	2,619	(159)

The redress for lower-income taxpayers is relatively small, while high-income individuals receive additional tax reductions, primarily as a result of the proposed rate structure.

It is, of course, not possible to assess the final impact of the proposed tax reform package until the proposals for sales tax reform are more clearly delineated. Our Government has major concerns in this area.

- Because sales taxes fall on all Canadians, without regard to their ability to pay, Manitoba cautions the federal government against reliance on the new sales tax for an increased share of its revenue. More particularly, sales taxes should not be increased to reduce the current surtaxes on personal and corporate incomes.

- Steps must be taken to ensure that a new federal sales tax will not be more burdensome to the poor. In order to minimize the most unfair aspects of sales taxes, steps should be taken to eliminate any tax on food. At the same time, the new federal sales tax credit should be expanded to shelter low-income consumers who already pay a disproportionate amount of their income in the form of federal sales and excise taxes and duties.

- The impacts of a broadened federal sales tax on regions outside of the Golden Triangle must be addressed. Consumers in these regions are concerned that inclusion of transportation costs in the federal sales tax base will add disproportionately to their costs. Suppliers are concerned that their ability to compete in central markets may be affected. These concerns are magnified with any substitution of sales tax for income tax.

- Finally, means must be found to ensure that broad application of a new federal sales tax will not reduce already limited resources for public services, including hospitals, schools and universities, public housing, and government and municipal programs.

Manitoba realizes that many important issues related to sales tax reform have not been resolved, and that further study and consultations are still required. We are encouraged that the federal government recognizes this and has decided not to initiate major sales tax restructuring immediately.

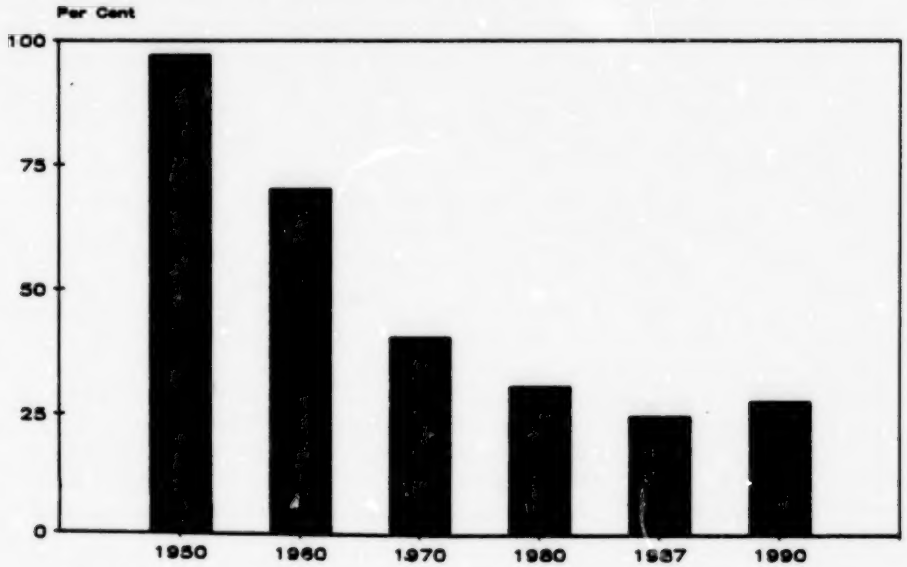
Specific Issues

On specific matters covered by the White Paper, we have identified broad areas of agreement, areas which require more discussion, and those which we feel are in need of fundamental restructuring.

a) Balancing Personal and Corporate Income Taxes

In looking at the sources of federal tax revenues, the most striking trends are the shifts away from investment to labour income, and away from the corporate to the personal sector. Corporate income taxes make up substantially less of total revenues today than it did even in the very recent past.

Corporate Income Taxes as a Percentage of Personal Income Taxes



This trend does not reflect the basic values of our society, nor does it garner the respect of the taxpaying public. In our Government's view, the White Paper proposals to lower corporate tax rates will not result in the corporate sector paying its fair share.

The projected reshifting of the tax burden from individuals to corporations is insignificant in relation to the imbalance which has been allowed to occur. The corporate sector will continue to pay a lower share of income taxes than even in the early '70s.

b) Corporate Rate Cuts

Manitoba opposes the deep cuts in corporate tax rates as presently proposed for big business and multinational corporations. It has been argued that this particular measure is necessary in order to provide tax rates "competitive" with those in the United States.

We should be extremely careful in making such comparisons, to take into account other differences as well. As the federal Finance Minister pointed out a year ago in Washington, aside from being a relatively young nation, our smaller population, sparsely spread out over a larger land mass, means that the cost per capita of maintaining a comparable infrastructure is much higher than in the U.S. with its larger population. Canadian governments provide extensive social safety nets that are otherwise supplied by employers in the U.S. For example, Canadian taxes pay for health care, while Americans must be provided with medical coverage privately. For most larger employers, the Canadian system represents a significant advantage. The Conference Board of Canada indicates that employers' contributions to public and private health plans in the U.S., as a percentage of payroll, is 6.1%, twice as much as the average expenditure in Canada.

In Manitoba's view, either the rate cuts should not be adopted, or, if adopted, other means must be found to secure fair corporate contributions for the cost of these services. Otherwise, Canada's ability to maintain vital services will be placed under increased pressure.

Any focus on comparability with U.S. tax reform should extend beyond tax rates to include other major differences in tax regimes. For example, the United States tax system includes virtually no provision for integrating personal and corporate income taxes; dividend income is fully taxed without tax credits. U.S. tax reform introduced a corporate minimum tax; Canada's tax reform proposals include no mechanism to ensure that all profitable corporations pay income tax. In many respects U.S. corporate base-broadening went significantly further than the proposals outlined in the White Paper. Depreciation allowances following U.S. tax reform are much less generous than the capital cost allowances proposed for Canadian reform. Similarly, depreciation rates for automobiles in the U.S. are tighter than the proposed changes for capital cost allowances for automobiles in Canada.

The White Paper estimates that even after tax reform, fully one-sixth of the income of profitable corporations will, on average, escape taxation. Worse yet, more than one-quarter of the income of financial institutions, insurance companies, and the real estate sector will escape taxation. Meanwhile, most Canadian wage earners can continue to count on 100% of their income being taxed and on taxes being deducted from each and every pay cheque.

c) Base-Broadening

Manitoba supports the proposed base-broadening under both the personal and corporate income tax systems. In our view, the goal of the base changes should be to ensure that all income is assessed and taxed in such a way that individuals and corporations in similar circumstances face the same tax liabilities. In general, the White Paper proposals make some progress in this respect.

d) Conversion of Exemptions and Deductions to Credits

The introduction of exemptions and deductions into the system over the years has seriously eroded its progressivity, so that high-income individuals gain a greater tax advantage than those on low-incomes using the same deductions and exemptions. For example, under the current system, the federal tax value of the basic personal exemption for a taxpayer with an income of $20,000 is $725, compared to a tax value of $1,240 for a taxpayer with an income of $100,000. Under the tax credit approach, all taxpayers will derive the same benefit from the basic personal credit.

Manitoba favours the proposed conversion of personal exemptions and certain deductions into tax credits. This is an important departure from the present system in that it provides the same adjustments to taxes for all taxpayers, regardless of their level of income.

e) Taxation of Wealth

Our Government is encouraged that the White Paper proposes to increase the portion of capital gains to be included in income, and to freeze the lifetime capital gains exemption limit at the 1987 level of $100,000.

Presently, Canada has no federal or provincial estate taxes or succession duties. Nor do we impose annual wealth taxes as some other countries. In this respect, Canada is virtually unique among OECD countries. Accordingly, there is no good rationale for further increases in tax exemptions for accumulating wealth and particularly for the capital gains exemption. Consideration should also be given to reintroducing wealth taxes in Canada.

Figures tabulated by the Joint Securities Industry Committee on Tax Reform show the inequitable distribution of tax burden between capital gains and employment income even after tax reform. For middle-income taxpayers, of each dollar of employment income, 60¢ is left after taxes. In contrast, 70¢ is left after taxes if the dollar is from capital gains.

AFTER-TAX INCOME FROM DIFFERENT SOURCES
(Federal Tax Reform Proposals)

	Low-Income Taxpayer (%)	Middle-Income Taxpayer (%)	High-Income Taxpayer (%)
Capital Gains	80.5	69.9	66.4
Employment	74.0	59.8	55.2

Clearly, the White Paper proposals do not go far enough in ensuring that investment and employment income are treated equally. Capital gains should be fully included in income. The capital gains exemption should be completely withdrawn except for family-farms and small businesses. The recent U.S. move to fully tax capital gains has drawn praise as a measure which recognizes the parity of capital gains with ordinary income.

Dividend income should also be fully taxed in the hands of the recipient. These steps are needed to assure fairness and the equitable distribution of the tax burden.

f) Registered Retirement Savings Plans

The White Paper proposed that increases in the maximum limits for RRSP contributions would be delayed one year. The proposed increases benefit only those Canadians with incomes greater than $42,000. Significant amounts of savings by wealthy Canadians will be removed from the tax base and the tax burden shifted onto ordinary working Canadians who are unable to set aside substantial savings. We see no reason to expect low- and moderate-income Canadians to provide tax subsidies so the wealthy can retire on tax-assisted incomes of up to $60,000.

Manitoba believes that the limits should be held at their present levels of $7,500. Serious consideration should also be given to converting these deductions to tax credits, as the White Paper proposes for the deductions for

Canada Pension Plan contributions and Unemployment Insurance premiums.

g) Personal Tax Rate Schedule

Manitoba has serious reservations regarding the lowering of the top tax rates for personal income. The history of previous tax reforms has been disappointing. Base-broadening has not persisted, while rate reductions have become permanent. Viewed in a historical perspective, there is little if any justification for additional reductions in maximum marginal tax rates.

The top two brackets, at 26% and 29%, are virtually flat, and diminish the progressivity of the personal income tax. The current proposals would reduce federal income taxes for those with more than $100,000 by about $1,300. Manitoba regards this as an affront to fairness.

h) Tax Expenditures

A key element of Manitoba's position on tax reform is our proposal for a systematic and thorough accounting and Parliamentary review of tax expenditures. We strongly urge this Committee to include a recommendation to this effect in its report to the Government.

A Parliamentary review would help determine whether a tax incentive or a direct expenditure is more appropriate in achieving policy objectives. At the same time, Canadians could be reasonably informed about the value of the taxes foregone. More importantly, it would assure ongoing, annual scrutiny of tax expenditures alongside direct program and service requirements. In all likelihood, such a review would not support the use of many expenditures currently provided and which the White Paper proposes to continue.

The generous flow-through share incentive for mining and oil and gas investments which allows tax deductions to "flow" from resource companies to investors is one example of why such a review is needed. As a portion of total spending in exploration, flow-through shares have increased rapidly from 12% in 1983 to an estimated 80% in 1986. For 1987, flow-through share financing of mineral and oil exploration is expected to total about $1 billion. While tax reform will gradually reduce the 133 1/3% tax deduction presently allowed to a 100% write-off, the costs to government in relation to the benefits remain a concern.

Our Government has not seen any compelling evidence to indicate that such financing is effective or encourages exploration that would not otherwise take place. The only certain result is higher taxes for those Canadians who cannot or do not take advantage of the provision. If such aid is needed, Manitoba would prefer to see such aid provided through direct support rather than through indiscriminate tax subsidies.

i) Tax Reform and Provincial Revenue Stability

In Manitoba's view, a reformed income tax system which eliminates many of the abuses and inequities of the past should provide a fairer and more secure financial base for public services. The White Paper proposals raise serious concerns in this regard. Nationally, the income tax proposals fall far below revenue neutrality and yield significantly less than the current inadequate system for 1988. Canadians should be wary of effects of revenue reduction of this magnitude on public services, on deficits and ultimately on the size and nature of federal sales tax increases in the future.

The federal reforms should provide provinces with at least the same revenues as the present system. If the federal government is confident of its projections, it should be prepared to guarantee that provinces will break-even under its proposals, much as was done with the 1972 reform. If the federal government is not confident about the fiscal impacts of its proposals, the implications for provincially-delivered public services are disturbing.

Conclusion

The Manitoba Government shares the view that fundamental tax reform is needed. During the consultations between the federal and provincial governments, Manitoba is continuing to press for improvements in the White Paper proposals to make the Canadian tax system significantly fairer.

Every federal budget has added to the patchwork of complexity we call our tax system. The fiscal base has eroded through time, and in its present form gives rise to many inequities. Each interest group has its own arguments against the particular ways in which taxes are levied. At this stage in the tax reform process, the federal government and this Committee must not be swayed by the self-interested complaints of the most vocal lobbyists. Instead, the

overriding obligation must be to recognize the grievances of ordinary Canadians who, in addition to absorbing deteriorating services, also shoulder an unfair share of the tax burden.